THE INDUSTRIALIZATION OF THE WEST COAST OF SOUTH AMERICA AND THE GOOD NEIGHBOR POLICY

BY

LEONARD GEORGE MATHY

A. B., University of Illinois, 1941

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AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
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In recent writings concerning the economic development of South America a new theme has become increasingly prominent. This theme points toward the growing industrialization and consequent self-sufficiency of South America as the solution of its economic dilemma. It is assumed quite simply that one area of the world after another is destined to undergo a process of development that will carry it from a primitive handicraft and barter economy into an active industrialization and consequent copartnership with other highly industrialized areas of the world. The recent stirrings and movements in existing South American industrial areas are interpreted, therefore, as the forewarnings of the appearance of a growing young giant about to set forth upon industrial adventure. It is also assumed that the prime responsibilities of the Good Neighbor Policy of the United States lie in the direction of financing a variety of emergency and long-run development projects through such agencies as the Export-Import Bank.

It is the purpose of this study, therefore, to examine the mineral and human resources, trade and investment problems, markets, physical and institutional barriers to trade and development, and other factors related to the industrialization of a selected region of South America—the West Coast Region—with a view to uncovering some of its potentialities and limitations, and to indicating the relationship existing between these findings and the proposals and programs for such industrialization instituted under the Good Neighbor Policy. The ultimate object, therefore, is an economic appraisal of the Good Neighbor Policy with respect to the problem of South American industrialization. A number of questions may be pursued in this connection. Is the Good Neighbor Policy designed to fit the economies of the United States and of the South American countries into a well-integrated world trade pattern? Or are we committed to the creation of a hemisphere economic bloc insofar as this is feasible?

If the latter policy is the one followed, is it designed along lines of compromise and mutual sacrifice to perfect a complementary relationship, or are certain changes being effected at the expense of one area? Is the United States dealing with the problems piecemeal (that is, in the interests of minority groups—exporters, importers, foreign bondholders, elite land-owning and mine-owning classes) or is the approach objective with the aim of benefitting the populations of each area without favoritism or undue advantage?

If we turn to a survey of the mineral and industrial possibilities of the West Coast, ample evidence may be found that the West Coast mineral industries have probably passed the zenith of their productivity and that the future prospects of some of the region's major mineral exports are not promising. Although it is true that some of the world's largest reserves of certain minerals are found in the region, it is also true that resources elsewhere in the world promise to surpass the West Coast deposits with respect to the all-important item of cost of production. Vast sums have been expended in developing these West Coast deposits, and yet, if production is to be maintained, further large expenditures must be made. In view of the none too favorable positions of some of the industries it is doubtful whether these expenditures will be forthcoming.

Declining mineral exports, no doubt, have been largely responsible for the avid interest many South American countries have shown toward the development of manufacturing industries, and these have appeared in large numbers. As war shortages developed, in particular, industries of every description put in their appearance and the list of products which are now produced in the West Coast and other South American countries is so extensive that a very fundamental question may be raised as to the production techniques which may prevail, even if the hundreds of producers of some of these goods should be eventually consolidated into large producing units.

Some of these industries, to be sure, are long overdue and can adequately supply certain basic consumer's needs. In Chile, for example, the control of soil erosion is being undertaken and efforts are being directed toward the improvement of agricultural techniques through the use of agricultural machinery, and the

development of irrigation and other devises designed to increase productivity. The stimulation of the fishing, fruit, and wine industries, bee-keeping and the raising of improved livestock also hold promise of higher standards of production and living.

On the other hand a number of industries of doubtful economic value are being actively promoted through the use of United States and local capital. Among these may be mentioned the production of automobile tires and tubes, machinery, locomotives and rolling stock, copper wire, synthetic petroleums, and chemicals. Chile and Peru are also subsidizing the development of copper mining, smelting, placer gold mining, the production of manganese, cobalt, coal, lead and silver, and the search for petroleum. Unfortunately some of these new developments are definitely marginal enterprises born of war-time necessity, and in the future they may represent disguised unemployment.

The most questionable development appears to be the stimulation of steel industries in Chile and Peru. Location, cost, and market factors are not particularly favorable, and a large obstacle to the successful operation of these industries lies in their small scale, for it is generally agreed that the minimum unit consistent with efficiency in operation is one producing from 350,000 to 400,000 tons annually. Another severe obstacle is found in the form of coal that is inadequate for metallurgical purposes.

Advocates of the industry invariably list cheap labor as an asset which will contribute to its ultimate success, and disregard the possibility that the labor may be quite ineffective and inefficient, and, therefore, scarcely cheap in terms of units of product for a given amount of labor. Even if it is assumed that the labor is highly efficient, cheap labor can scarcely be termed an advantage. The low rates of remuneration for the laborer offer no benefit to him. The stimulation of industries requiring large quantities of cheap labor is scarcely an ideal solution for an economy, although such industries may provide large national revenues and profitable return for various enterpreneurs.

It must be concluded that the example of the United States and its highly integrated economy with a large degree of balance between industry and agriculture appears to be the motivating

force behind much of the industrial development of the West Coast, but it is one that cannot be followed by small countries such as Chile or Peru. There is sufficient evidence that a wide base of tariffs and other modes of protection may lead to a great diversity of small-scale industries. In the very diversity of such industries, however, lies their weakness, for in view of limited markets, skilled labor, and capital resources, a large number of industries cannot attain efficient size and must of necessity be high-cost enterprises. The best solution seems to lie in the opposite direction—in specialization in those activities which are definitely and properly small-scale and in the attainment of modern methods of agricultural production in order to meet the needs of their people.

Nonetheless local industrial development of any type might well be expected to increase the standards of living in the countries in which they appear. The argument that the productive resources of a country may be used to poor advantage when devoted to protected heavy industries may be lessened to some degree when it is pointed out that the so-called state of full employment which seems to exist in some of the countries really represents a condition of large-scale and disguised unemployment in which thousands of workers may be engaged in unproductive handicrafts and menial occupations resulting in insignificant additions to production. The movement of these workers to more productive occupations should certainly prove desirable in an absolute sense. It would not be surprising, therefore, if the position of the worker becomes a better one despite the type of industry in which he may find employment. In view of these problems, it is clear that the economic merit of these and other developments directly affected by the Good Neighbor Policy are open to question, and throw considerable doubt upon the effectiveness and consistency of purpose of the Policy as a whole.

Although the original, universal application of the Policy has by no means been abandoned in official references to the Policy, it has been evident from the very beginning that the universal character of the Policy has faded into oblivion for all practical purposes, and has been supplanted by an ardent—almost psychopathic—desire to woo the so-called Latin American "republics" to the side of democratic ideology. The growth of such paternal-

istic institutions as the Pan-American Union and innumerable official and quasi-official organizations created for the purpose of facilitating inter-American harmony bears ample testimony to the fact that inter-American relations have occupied an important and sheltered position in American economic foreign policy to the exclusion of relations with other equally undeveloped areas which are also in need of the helping hand of a "good neighbor."

The early conclusion of trade agreements with a number of Latin American countries, coupled with inter-American conferences and other activities directed toward the amelioration of political and economic relations, marked the beginning of a process which later, due to military and political ends, was to culminate in active participation in discriminatory practices against other world producers. Among these activities born of military necessity, was extensive research in the development of rubber production and the production of other tropical products hitherto obtained from other world sources. Mineral production was also brought to a high level and commitments were made for the purchase of such materials at remunerative prices—prices deliberately adjusted upward to include the costs of long-run capital improvements, including transportation. The urgent need for such developmental programs cannot be questioned, but it must be recognized that the long-run implications of such commitments within this hemisphere point toward the permanent injury of other world producing areas. Insofar as this is true, the Good Neighbor Policy has become a restricted and preferential policy.

Another indication that the implemental agencies of the Good Neighbor Policy have been swept unwittingly into directions contrary to the goals of the Policy is found in the extensive provisions of funds for the ostensible purpose of stimulating useful industries but which, it has been shown, subsequently have been used for nationalistic purposes inconsistent with the resources and abilities of the countries undertaking these projects. It has been anticipated that such development would be a healthy and long over-due movement toward the decentralization of consumers' goods industries, but in practice, some Latin American nations have eagerly sought virtually all types of production, have erected barriers to trade, and in general have moved far in the

direction of autarchic systems basically inconsistent with the principles of the Good Neighbor Policy.

Exceptions to the most-favored-nation principle, the cornerstone of a multilateral trade system, have been condoned by the State Department. As a result, inter-American preferential agreements have been consummated—thus foreshadowing a movement toward greater inter-American trade along lines in distinct contradiction to the liberal trade policies incorporated in the Good Neighbor Policy. These tentative steps in the direction of inter-American preferential trade systems have provided an embarrassing precedent which may well have a weakening effect upon the efforts of the United States to bring about a relaxation of similar practices in other hegemonies.

The widely accepted thesis that the Latin American economies needed to be strengthened lest they should fall easy prey to encroaching fascist economic penetration provides an explanation for no small part of the progress for Latin American development, and yet there is a fundamental enigma in the growth of the pro-fascist government of Argentina. The emergence of such a system in economically strong Argentina, which spurned financial aid at the time when it was generously offered to other Latin American "republics," is contrary to all expectations, although the supposed difference between the totalitarianism of Argentina and similar political institutions elsewhere in Latin America should not be pressed too far. It would be unwise, however, to suppose that the strengthening of Latin American economies necessarily will make them more kindly disposed toward the United States. A form of headstrong nationalism seems to be the more logical consequence of such economic strength.

A curious note has been struck in the mechanisms through which the economic defense of the Americas has been implemented. For the most part, the aid which has been extended has been in the form of intergovernmental loans which in turn have been utilized to control and direct business enterprises normally considered to lie within the sacred confines of private enterprise. Although it is held that the object of the loans is to aid private capital in economic development, the direction and control of steel production and similar industries will lie in the

hands of Latin American governments. The process of extending a loan to a foreign government-controlled enterprise is in direct opposition to the allegation that governmental direction of industry is an unwarranted venture in the direction of a socialistic system and to similar dogmas of private enterprise which are vigorously promoted. The manner of the extension of such loans (it does not appear likely that the funds will be forthcoming from purely private sources in view of the default records of these countries) provides a rather doubtful demonstration of the superiority of a system of private capitalism. The resolutions taken at the various meetings of foreign ministers distinctly adhered to the principles of private capitalism, yet the evidence, whether it is a product of war emergency or a recognition of a failure of private capitalism to allocate productive resources properly, points toward a deeply ingrained movement in the direction of a planned economic development.

Needless to say, similar deviations from the precepts of a capitalistic state have long been an integral feature of the domestic economy of the United States, but the professions of faith in the merits of private capitalism which can be found in large sectors of American business and government deny the more concrete realities of the changing scope and functions of a government. These deviations from laissez-faire economic doctrines indicate a fundamental cleavage between fact and fancy in American economic life. A similar paradox in thought and action is observable in the United States foreign policy, for the unequivocal expressions of faith in free and uncontrolled world trade are clearly in opposition to the current United States practice of effecting unilateral control over some of the economies in Latin America, and of exercising a large degree of influence in the directions of economic development of others.

Moreover, if the apparent conflict between principal and practice in the domestic and foreign economic policies of the United States is laid aside for the moment, there has been a large degree of confusion over the problem of which direction Latin American economic development should take. There are vigorous and influential proponents of the development of bilateral trade through the stimulation of non-competitive agricultural products, and others who advocate the importation of

Latin America's competitive mineral and agricultural products.

As such, the United States economic policy has been a tool used for the benefit of particular economic interests and, aside from primary military objectives, it has given only secondary recognition to the probable effects of such loans upon other regions. It has been stated that a large element of safety exists in the loans which have been made inasmuch as they are granted only for economic purposes and the funds for repayment must be earmarked in advance. While this noble practice diminishes considerably the risk involved, it does not insure against the use of the funds in relatively uneconomic pursuits. More often than not United States loans have involved a poorly veiled attempt to enlarge the holds of the United States exporters upon Latin American markets through banking devices very much akin to subsidies. Other nations, now in desperate competitive positions in view of their destroyed and obsolete capital facilities and their dependence upon these former markets, will of necessity be forced to wage a bitter struggle to regain their trade ties. This will be doubly complex since it would seem that United States exporters have struck telling blows in a new economic war the end results of which are unpleasant to contemplate.

On the other hand, the exploitation of Latin America has not been a one-sided affair, for the price of Latin American economic cooperation has not been an insignificant one. There is no necessity to enter the controversy begun by Senator Butler when he contended that "Our South and Central American program calls for an investment by American taxpayers of about $6,000,000,000 by the end of 1944."[1] While this claim has been proven to have been extravagant, it is nonetheless true that extensive and remunerative commitments in the form of excellent prices (in which were included capital improvement of lasting benefit) and outright grants-in-aid were advanced as the price paid for Latin American friendship and cooperation. It should be remembered that such generous treatment was accorded in the face of discriminatory taxation, other discriminatory revenue devices,

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[1] United States Senate, "Expenditures and Commitments by the United States Government in or for Latin America," Senate Document 132, Washington, D. C., December, 1943, p. 36-46.

and outright confiscation.[2]

A major flaw in the operation of the Good Neighbor Policy has been the careful canalization, both in principal and practice, of Latin American industry into non-competitive lines of production, despite the fact that the countries are not always ideally situated for such lines of development. Although the United States has applauded the mechanism of free trade as a device well-suited to perform a regulative function in the growth of industry along lines of specialization and greatest efficiency, it has carefully prescribed that the activities of developmental organizations should be directed toward the development of non-competitive lines of production. This policy, of course, is a direct denial of the advantages which accrue through geographic specialization when and if it becomes evident that a hitherto undeveloped area is capable of surpassing older and better established producing regions. It indicates that the intent of the American economic policy is not synchronized with dynamic developments in world economies, but is blindly directed toward the restoration of the "status quo ante".

Failing markets for United States agricultural products and the emergence of new sources of world supply indicate that a readjustment in agricultural and industrial production may be required. However, little evidence exists in United States world trade programs that the need for a readjustment has received any considerable recognition. Export subsidies, trade agreements, and international commodity agreements are aimed at the elimination of new and potential sources of competition, and at the

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2 For example, on February 12, 1942, the Bolivian government agreed to pay the Standard Oil Company of New Jersey the sum of $1,500,000 in United States currency for the "sale" of all its rights, interests, and properties in Bolivia which were expropriated in 1937.

"At the same time it was announced that the Export-Import Bank of Washington will grant Bolivia a $5,500,000 loan for the development of the oil industry in Bolivia. This loan is separate from the $25,000,000 granted the Bolivian government for the Corporacion de Fomento, also created by the agreement signed in Rio de Janeiro by the Minister of Foreign Affairs of Bolivia, and the Undersecretary of State of the United States." See "Bulletin of Pan American Union," June 1942, p. 354.

reopening of artificially closed markets. In the light of these practices the interest of the United States in Latin American manufactures takes on a new meaning, for these manufactures, which we have been assured will offer no competition in world trade, apparently serve the purpose of diverting Latin American production into certain "safe" channels.

At first glance, it would seem unwise, of course, to advocate that these regions should take up lines of production in which chronic surpluses have occurred. However, the very existence of these surpluses is objective evidence of an inherent inflexibility of structure in existing world producing areas as world demand and supply conditions are in transition. Quota agreements and other devices designed artificially to obstruct the growth of new and more economic sources of supply are further evidences of a reluctance in some quarters to adhere to liberal trade principles. If these considerations are borne in mind, there appears to be a considerable degree of logic in the suggestion that there is more to be gained through a readjustment in favor of new producing areas and a gradual and, let us hope, relatively painless transition toward other types of production within the United States and other world economies. It is axiomatic that greater freedom for economic growth along lines of comparative advantage must also involve opportunity for a reasonable degree of adaptation of productive resources to innate changes in world abilities to produce. Because such flexibility is virtually non-existent in United States mechanisms for the promotion of trade, it can be said that lip-service rather than active participation has characterized the role of the United States in the promotion of liberal economic policies.

It must be admitted that whole-hearted embracement of liberal trade doctrines, after restrictive trade policies have held sway for decades, cannot be readily consummated in view of the deep-rooted nature of protected industries, although these high cost establishments would disappear from the scene under the blow of strong world competition if relative freedom of trade were to be put in effect suddenly. There is danger that such a movement would overlook the extent to which capital of a highly specialized character is bound up on the protected industries, allied industries, and service institutions; and that it would also

neglect the problem of relocating large numbers of people, and similar factors which would weigh heavily against the reallocation of productive resources along lines indicated by the theoretical aspects of the problem. However, there is also reason to argue that further impediments should not be added to those already in existence, and that some moderate adjustments could be made without injury. In any event, the basic tenets of the Good Neighbor Policy involve proposals to bring these changes about, and, insofar as there is a failure to achieve them, the Policy has failed to live up to its objectives.

In operation, therefore, the Good Neighbor Policy has tended to move in directions and to deal with political and economic systems that are inconsistent with the economic principles laid down in the Policy. Political, military, and economic motives have been inextricably interwoven, and actions taken on behalf of one objective have been hailed loudly as beneficial on other grounds as well. By this line of reasoning the active support of the Latin American economies, generated by military necessity in the early phase of World War II, has come to be viewed as an integral part of a long-run economic program designed to confer inestimable benefits on all. And this belief persists despite the fact that it may be shown that many of the industries are of a highly questionable nature and frequently owe their origin to a desire to conserve exchange at any cost, whether the country in question is able to operate these industries economically or not. In this manner, manual industries have been stimulated as a means of creating employment and as a device to provide or conserve needed exchange, although such labor used is frequently of low productivity.

Loans advanced in return for promises on the part of Latin American countries to adhere to uncontrolled foreign trade promise to be abortive attempts to restore world trade along liberal lines, for such loans have been instrumental in the birth of a new economic nationalism within certain countries. Far from achieving the end of more liberal trade it now appears that the funds are largely in the hands of a nationalistic fomentos which have created industries requiring protection for an indefinitely long period of time. Although these loans have been profitable for certain United States producers, they have been made in the face

of rather shabby treatment of the holders of the dollar bonds of these countries.

The new nationalism runs counter to modern requirements for efficiency in production as technological developments continue to place small producing areas at a disadvantage, because of their inability to meet the need for large-scale diversification and specialization along vertical and horizontal lines. In their efforts to meet more effective competition elsewhere, these areas will be unable to achieve a level of output which will enable them to make use of specialized capital or to benefit from external economies. Therefore, successful competition will only be achieved through the combination of productive factors along lines in which labor will be treated as the cheap or most abundant element. Such a mode of production can only react to the permanent disadvantage of labor.

Moreover, the new nationalism is based upon margins of comparative advantage which reflect artificially altered ratios of exchange resulting from controls and practices throughout the world designed to favor certain nationals. This makes it impossible to state whether an industry which is now economic would continue to be so under more normal conditions of exchange. Restrictive trade practice, such as tariffs, have also altered the conditions of trade through their effect upon the reciprocal demand of nations for each others' products and the resultant depreciation of the exchange of the countries which have suffered most from such restrictions. In effect, fewer goods and services are obtainable from the exports of such countries and domestic manufacturers appear to be a most desirable development.

In the last analysis, it is perhaps somewhat absurd to be concerned about expenditure of a few hundred million dollars, which promise absolute gain now or in the distant future, when billions of dollars have been spent for far less noble purposes and, certainly, no economic gain. These, however, are mistakes and problems which should be relegated to the past. If anything, these errors have augmented the need for a reorientation in American thought and action. There must be a careful segregation and examination of motives and an honest appraisal of

the value of economic subsidies as a tool for the accomplishment of political and military goals. Again, economic programs must be related to the needs of the nation as a whole and to their effects upon the progress of world economic development as a whole instead of involving a myopic consideration of benefits of a purely restricted nature. It is time for governmental policies, economic or otherwise, to cut across the verdant jungle of individual greed, to abandon the missionary-like cloak thrown over policies governed by other motives, and to be lifted to a mold which conforms to world needs.

Vita

The author was born in Chicago, Illinois on September 8, 1918. He received his early schooling in that city and was graduated from Hirsch High School in 1936. His freshman and sophomore years in college were completed at Valparaiso University and the Woodrow Wilson Junior College of Chicago, respectively. In 1939 he entered the University of Illinois and was graduated with the degree of Bachelor of Arts in 1941. Thereafter he entered the Graduate School of the University in 1942 with a graduate scholarship and received the degree of Master of Arts in Economics in 1943. He continued his studies for the doctorate in 1944 and 1945 as a Fellow in Economics. Since the spring of 1945 he has been an instructor in the College of Economics and Business at the University of Washington. He is a member of Pan Xenia, international foreign trade honorary society and has been elected to membership in Beta Gamma Sigma, national commerce honorary society.